

Legislative Notice

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H.R. 831 — Permanent Extension of Deduction for Health Insurance Costs of Self-Employed Individuals

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Reported from the Committee on Finance on March 20, 1995, with an amendment in the nature of a substitute, by voice vote. S. Rept. 104-16. Senators Moynihan and Moseley-Braun filed additional views.

NOTEWORTHY

- H.R. 831 provides a 25-percent deduction for health insurance expenses of self-employed individuals for the 1994 tax year, and a 30-percent deduction for tax years beginning in 1995 and thereafter.
- CBO estimates that the federal government will lose \$3.47 billion in projected revenue through FY 2000 as a result of this provision.
- These revenue losses are more than offset by provisions in the bill that place limitations on the Earned Income Tax Credit (EITC), that bar the Federal Communications Commission (FCC) from issuing tax certificates to persons who voluntarily sell broadcast facilities to minority individuals or minority-controlled entities, and that levy a tax on people who relinquish their U.S. citizenship. All told, the bill as reported will reduce the federal deficit by \$1.40 billion over five years, according to CBO.

BACKGROUND

Deductibility of Health Insurance Premiums

Health benefits provided through an employment-based plan are not subject to federal income or payroll taxes. But individuals who purchase health insurance outside the employment setting receive no tax benefits, unless their expenditures exceed 7.5 percent of their adjusted gross income.

Beginning in 1986, self-employed individuals and their spouses and dependents were permitted to deduct 25 percent of their health insurance premiums. This temporary provision expired and was extended several times. It last expired on December 31, 1993. H.R. 831 would retroactively restore the tax break for tax year 1994, thus enabling the self-employed to claim the 25-percent deduction when they file their federal income taxes next month. In addition, the bill would establish a permanent 30-percent deduction. These tax changes will reduce projected federal revenues by \$3.47 billion through FY 2000, according to CBO.

The "Viacom Offset"

In January of this year, the media reported that Viacom, Inc., a large publicly-held company, had agreed to sell its cable systems serving 1.1 million customers to a partnership composed of a minority-group-owned company (Mitgo Corp.) and InterMedia, a limited partnership. Viacom would reportedly realize a profit of \$1.1 billion to \$1.6 billion from the sale.

Because the transaction involves a firm controlled by members of a minority group, Viacom is seeking to obtain a "tax certificate" from the FCC, enabling it to defer taxes on profits from the sale. According to the Joint Committee on Taxation, Viacom would be able to defer \$440 million to \$640 million in federal and state taxes if they obtain the certificate.

History of the "Viacom Offset"

The FCC's authority to issue tax certificates derives from section 1071 of the Internal Revenue Code. Section 1071 was originally enacted in 1943 in response to a new FCC policy that prohibited licensees from owning more than one radio station per market. This new "duopoly rule" forced 35 licensees, each of whom held two licenses in one market, to divest themselves involuntarily of a license. Enactment of section 1071 enabled these licensees to obtain a tax certificate from the FCC, deferring taxes on any "sale or exchange [] necessary or appropriate to effectuate the policies of the Commission with respect to ownership or control of radio broadcasting stations."

In 1978, the FCC announced a policy of promoting minority ownership of broadcast facilities by offering FCC tax certificates to those who voluntarily sell their facilities to minority individuals or minority-controlled entities. For this policy, the FCC defines minorities as "including Blacks, Hispanics, American Indians, Alaska Natives, Asians and Pacific Islanders." The agency defined a minority-controlled corporation as one in which more than 50 percent of the voting stock is held by minorities. A minority-controlled limited partnership is one in which the general partner is a minority or minority-controlled, and minorities have at least a 20-percent interest in the partnership.

In 1982, the FCC expanded the policy further, granting tax certificates, not only to entities that sell properties to minorities, but also to investors who help provide capital to minority enterprises. To qualify for a tax certificate, investors must either: (1) provide start-up financing that allows a minority to acquire either broadcast or cable properties; or (2) purchase shares in a minority-controlled entity within the first year after the minority firm obtains a license to operate a property.

Since FY88, Congress has passed appropriations riders that prohibit the FCC to repeal, make retroactive changes to, or reexamine its tax certificate policies. The appropriations provision does not, however, bar the FCC from expanding the policy. In 1993, it did just that, providing for the issuance of tax certificates to help women and minorities obtain licenses to provide personal communications services (e.g., small, multi-function portable phones, portable fax machines, advanced paging devices).

Effectiveness of the "Viacom Offset"

Since 1978, the FCC has issued 360 tax certificates under the minority ownership program. Some of these certificates were issued for sales that transferred licenses from one minority to another, and therefore did not increase the number of broadcast licenses held by minorities. In the early years of the program, the number of licenses held by minorities increased. In 1978, minorities held 0.5 percent of licenses; in the mid-1980s, that number had risen to 3 percent. In recent years that percentage has stagnated, and the National Telecommunications and Information Administration reports that minority persons today hold 2.9 percent of all broadcast licenses.

Criticisms of the "Viacom Offset"

The Viacom deal struck earlier this year has focused considerable attention on section 1071 of the Internal Revenue Code. Many people were surprised to learn that a multi-billion dollar firm could receive tax deferments in excess of half a billion dollars on the basis of a policy that is supposed to help minorities. The Viacom deal has led to sharp criticisms of the program.

Some have noted that, in granting tax certificates for voluntary sales of broadcast properties, the FCC has gone far beyond the original congressional intent. Section 1071 was enacted more than half a century ago to protect broadcasters who were forced, because of FCC actions, to sell radio stations. The FCC now uses the provision to grant unlimited tax benefits for routine and voluntary sales of a wide range of communication properties.

Others have noted that the FCC's definition of minority "control" is so vague that it does not assure that minorities will effectively manage a broadcast property after the sale of the property has been certified. In addition, the FCC does not require the minority purchasing group to hold onto the property for a significant length of time.

Still others criticize the fact that the FCC is able to issue tax certificates without IRS supervision. As a result, the program has not been subjected to systematic review and taxpayers don't know which firms are getting tax breaks and how much they're benefitting. Indeed, the FCC does not take into account the size of the potential tax benefit involved when it issues tax certificates. Critics say that no other provision of the Internal Revenue Code conveys that level of discretion to a federal agency. This discretion, according to critics, amounts to an open-ended entitlement program that lacks any external constraints.

The tax certificate program also has been faulted as the only federal statutory or administrative provision that conveys tax benefits solely on the basis of racial status.

The House Bill's Treatment of the "Viacom Offset"

The House bill (which permanently extends the self-employed health deduction at 25 percent) also repeals section 1071 of the Internal Revenue Code. This repeal is effective for: (1) sales or exchanges on or after January 17, 1995 (the date that House Ways and Means Committee Chairman Bill Archer issued a press release indicating that his Committee would undertake a review of section 1071); and (2) sales or exchanges before January 17 if the FCC tax certificate with respect to the sale or exchange is issued on or after that date. The provision does not apply to taxpayers who entered into a binding written contract before January 17 and who applied for an FCC tax certificate by that date.

Viacom did not have such a "binding agreement" because its sale was contingent on issuance of an FCC tax certificate. The House bill would thus bar the FCC from issuing a tax certificate to Viacom.

The House passed H.R. 831 on February 21, 1995, by a vote of 381-44.

BILL PROVISIONS

Section 1 restores the 25-percent deductibility of health insurance premiums for the self-employed for tax year 1994. Beginning in tax year 1995, this will be raised to 30 percent.

Section 2 repeals section 1071 of the Internal Revenue Code. The repeal applies to: 1) sales or exchanges on or after January 17, 1995; and 2) sales or exchanges before that date if the FCC tax certificate with respect to the sale or exchange is issued on or after that date.

Section 3 amends section 1033 of the Internal Revenue Code, which allows taxpayers to defer taxes from involuntary conversions of property to the extent the taxpayer purchases property similar or related in service or use to the converted property. Current IRS rulings allow, in some cases, such tax deferrals to be claimed in cases where the taxpayer acquires property from a related person. Section 3 would change this, requiring that to qualify for the deferral, a taxpayer must purchase property from an unrelated person.

Section 3 also amends Section 1033 by allowing tax deferrals for sales or exchanges that are certified by the FCC as having been made by a taxpayer in connection with the relocation of the taxpayer from a portion of the broadcast spectrum (1850-1990MHz). The FCC is currently reallocating that portion of the spectrum for personal communications services (for example, small, lightweight, multi-function portable phones).

Section 4 modifies the Earned Income Tax Credit (EITC). The EITC is a refundable tax credit available to certain low-income workers. The size of the credit depends on the number of children in the household and on earned income. Families with two children are ineligible for the credit in 1995 if they earn more than \$26,673. The maximum earnings for a family with one child is \$24,396; households with no children are ineligible for the credit if earnings exceed \$9,230. There is no limit, however, on income from interest, dividends or rents and royalties. Section 4 would deny the credit to any household whose combined income from interest, dividends and rents and royalties exceeds \$2,450.

Section 5 deals with the taxation of assets of individuals who relinquish U.S. citizenship. Under current law people who renounce their citizenship, and whose principal reason for doing so is to avoid federal tax, are subject to an alternative taxing method. This provision, in the judgment of the Finance Committee, is "largely ineffective" because it is difficult to prove that an individual relinquished citizenship primarily to avoid U.S. taxes. Section 5 provides that anyone who relinquishes his or her citizenship will be deemed to have sold all personal property at fair market value immediately prior to the expatriation. Net gain on the deemed sale is taxable only to the extent it exceeds \$600,000 (\$1.2 million in the case of married individuals filing joint returns, if both expatriate). *NOTE: The Committee report states that this provision was adopted "in order to reduce the federal budget deficit. The Committee does not intend that the revenue raised from this provision be used to offset the tax-relief provisions of the bill or of any subsequent legislation."*

COST

The Committee, in an estimate prepared by the Joint Committee on Taxation, estimates the following budget effects of H.R. 831, as amended and reported.

	FY95	FY96	FY97	FY98	FY99	FY00	FY95-00
	(in millions of dollars)						
1. Extend self-employed deduction	-514	-482	-527	-587	-649	-708	-3,467
2. Repeal section 1071	334	411	135	135	170	201	1,386
3. Modify section 1033	5	9	23	33	47	67	184
4. Modify EITC	0	21	415	465	501	540	1,941
5. Revise tax treatment of expatriates	47	144	197	257	322	392	1,359
Net Totals	-128	103	243	303	391	492	1,403

CBO reports H.R. 831 would affect receipts, and so pay-as-you-go procedures would apply. They are summarized below (in billions of dollars):

	FY95	FY96	FY97	FY98
Changes in receipts	-.128	.086	-.091	-.072
Changes in outlays	0	-.017	-.334	-.375

REGULATORY IMPACT

Section 4 will involve an additional calculation by taxpayers who may be eligible for the EITC to determine if they are subject to the \$2,450 limit on unearned income.

Section 5 will involve increased reporting of information to the federal government by people who relinquish their U.S. citizenship. It also will require them to file additional tax forms to comply with the provision.

ADMINISTRATION POSITION

On February 21, 1995, OMB issued its Statement of Administration Policy (SAP) on the House bill. The SAP stated the Administration's support for "the primary purpose of H.R. 831 — to extend permanently the 25 percent tax deduction for health insurance premiums for self-employed individuals. The Administration opposes one of the bill's offsets — i.e., the outright repeal of the current tax treatment for the sale of radio and television broadcast facilities and cable television systems to minority-owned businesses. . . .The Administration will work with the Congress to identify appropriate offsets to extend this important health insurance deduction."

At press time, no Statement of Administration Policy on the Senate version of the bill was available.

OTHER VIEWS

Senators Moynihan and Moseley-Braun

"During the Finance Committee's consideration of H.R. 831, Senator Moynihan offered amendments that would have eliminated the retroactive repeal of Internal Revenue Code section 1071 from the bill . . . Senator Moynihan's amendment proposed instead an alternative source to raise the same revenue: a proposal from the Administration's FY 96 Budget designed to prevent tax avoidance by U.S. citizens who renounce their citizenship. This amendment accomplished the primary objective of H.R. 831, that is, to act expeditiously on the 25 percent health insurance deduction for the self-employed prior to the filing deadline for the 1994 tax year. Retroactive repeal of section 1071 was not necessary to accomplish this objective . . .

"Valid questions have been raised about the way that section 1071 is currently being administered. Recognizing this fact, the amendment would have provided a moratorium of up to two years on the provision. . . .

"The Committee is aware of at least 19 transactions that were negotiated in reliance on the existence of section 1071 and had FCC tax certificate applications pending at the time the House voted to retroactively repeal the provision. . . .Businesses cannot plan, cannot negotiate, and cannot compete on a fair basis under the threat of this kind of retroactive reversal of the law

"In addition to paying for an extension of the self-employed health insurance deduction without resort to a retroactive repeal of section 1071, the amendment contained two additional time sensitive provisions.

"First, the amendment included a measure providing that the diesel fuel dyeing requirements for tax administration purposes, enacted in 1993, would not apply in any state that is exempted from the fuel dyeing requirements of the Clean Air Act. . . . [Second,] the amendment would have permitted the State of New York to continue operating an inpatient hospital reimbursement system that has been in place since 1983. . . . This reimbursement system is being challenged in the Federal courts as impermissible state regulation of employer group health plans. . . .

"In summary, the Moynihan amendments addressed the time-sensitive need to extend the self-employed health insurance deduction in advance of the 1994 tax filing deadline without embroiling that issue in the twin controversies of precipitous repeal of the minority broadcast tax preference program or of retroactive tax provisions."

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